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2026 South Carolina Bankers School

Troubled Assets

How to Identify Them, Manage Them, and Minimize Bank Losses

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Section 1 – What is a "Troubled Asset"?

"Trouble, Trouble, Trouble…." Ray Lamontagne

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Classified vs. Nonperforming Assets; Additional Terminology

Adversely Classified Assets: Assets *subjectively* graded as higher risk and more likely to produce a loss (usually also non-performing).

- Substandard: Assets inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged. Well-defined weakness(es) that jeopardize liquidation of the debt. Characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. OREO is usually classified Substandard.
- Doubtful: Substandard assets plus the added characteristic that the weakness makes collection or liquidation in full, on the basis of existing facts, conditions and values, highly questionable and improbable. The likelihood of a loss on portion of a loan is high.
- Loss: Assets considered uncollectible and of such little value that their continuance as bankable assets is not warranted.

Non-Performing Assets: Loans in non-accrual status (i.e., 90+ days past due) plus Other Real Estate Owned (OREO).

- All NPAs should be adversely classified.
- NPAs affect income more severely than classified assets.

Other Common Terms:
- Criticized Assets
- Impaired Assets
- Modified or Troubled Debt Restructured (TDR) Assets
- Problem or Troubled Assets

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Measurement Methods / Benchmark Ratios : The "A" in C.A.M.E.L.S.

Two Very Important Calculation Examples: Texas Ratio and Coverage Ratio

Texas Ratio: Non-performing Assets / [Tangible Equity + Allowance for Credit Losses (ACL)]

Calculation Sample: ABC Bank: $1 Billion in Assets; $800 million in Loans; $100 million in Equity+ACL; Total NPAs of $3 million

Texas Ratio = 3% $3 million NPAs / $100 million Equity+ACL

Adversely Classified "Coverage Ratio": Total Classifieds / [Tangible Equity + Allowance for Credit Losses (ACL)]

Calculation Sample: ABC Bank: $1 Billion in Assets; $800 million in Loans; $100 million in Equity+ACL; $12 million Substandard Loans+OREO

Coverage Ratio = 12% $12 million Total Classifieds / $100 million Equity+ACL

Other Asset Quality Ratios
- Non-performing Assets / Total Assets
- Non-performing Loans / Loans
- Delinquent Loans / Loans
- Net Charge-offs / Loans
- Allowance for Credit Losses (ACL) / Loans
- Allowance for Credit Losses (ACL) / Non-performing Loans

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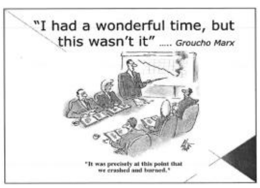
Section 2 – Identifying and Managing Troubled Assets

Three Stages: Early, During, and Late in the Credit Cycle



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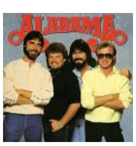
Identifying Troubled Assets

Early in the Credit Cycle: the "Good Times"

"Ain't Life Grand…" Widespread Panic



"We were living in high cotton…." Alabama

Notable Quotes:
"The worst decisions are often made during the best of times." – A Seasoned Bank CEO
"Some good loans go bad; all bad loans stay bad." – Unknown Credit Administrator
"An ounce of prevention is worth a pound of cure." – Lender's Counsel (or Ben Franklin)

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Identifying Troubled Assets
Early in the Credit Cycle - Things to Consider

Understand and Align with Your Bank's Credit Culture / Risk Appetite
- What are we targeting (deep relationships vs. growth and market share; something else)?
- Does our credit culture prioritize "eating well or sleeping well"?
- Are our loan goals aligned with our incentives (credit quality and risk management)?
- Do we respect the checks and balances at my Bank (are we even playing on the same team)?

Review and Respect Policies and Procedures Designed for Risk Mitigation
- Am I "cutting corners" to win business? (loan concessions; policy deviations; etc.)
- Am I demonstrating good habits and discipline? (analyzing the global financial picture; etc.)
- Have I visited the project or company and/or stressed the assumptions? (rapidly rising appraised values, falling cap rates)
- Is there a pre-closing review process? (if not, am I going the extra mile?)

Maintain the Relationship Post Closing
- Am I in a continuous relationship with Borrower or did I book the loan and forget it?
- Has borrower changed things post-closing? (covenants; draws; lien waivers; insurance; etc.)
- Can I identify the "Weakest Link" in my deal?

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Identifying and Managing Troubled Assets
During the Middle of Credit Cycle

"The Times are Changing" Bob Dylan

"Warning Signs" Coldplay

Notable Quotes:
"A rolling stone gathers no moss and a rolling loan gathers no loss." – A Disapproving Bank Examiner
"When the music stops, things could get complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing." – A Terminated Bank Executive
"When you see a cockroach, there are probably more….." - Jamie Dimon

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Identifying and Managing Troubled Assets
During the Middle of Credit Cycle

Monitor *Broad* Economic Signals (the Changing Times)

- Macro-events: Government Policies (Stimulus; Tariffs; Tax Credits; DOGE/Govt. Leases) Legislation (BBB); Student Loan Repayment; Pandemic; Geo-politics of War (Oil Prices); Interest Rate Volatility (Inflation/Deflation); Transformative Inventions (A.I.)
- Regional or Local Events: Unemployment; Local Ordinances (VRBO; Historic areas; permit allocation restrictions); Property Values/Taxes

Heed *Specific* Warning Signs

- Slow Payments; Overdrafts; Delinquent Taxes; Evasive Borrower; Missing Financials; Litigation/Subpoenas; Personnel Turnover; Rapid Irresponsible Growth; Requests to Modify Debt; Excessive Renewals; Draw Request/Change Order Issues; Insurance Cancellations; Property Values and Lease Renewals; Tenant Evictions; Rescinded Sales Contracts; etc.

Always Keep Bank Management Informed

- Is the loan classified correctly over time and properly reserved; is default or non-accrual imminent?
- Do I have the most up to date information (financials from borrower; updated valuation)?
- Do we need to engage an attorney to address legal or contractual issues?

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Managing Troubled Assets
Late in the Credit Cycle

"Easy Come, Easy Go" George Strait

"Give it Away" Red Hot Chili Peppers

Notable Quotes:
"It's a person's ignorance that gets them into trouble and their arrogance that keeps them there." - Unknown
"He went bankrupt two ways: gradually, and then suddenly." – Hemmingway

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Managing Troubled Assets
Late in the Credit Cycle: "Addressing a Potential Mess"

Engage Proactively With Your Borrower

- Meet in Person (determine location); Set Tone/Expectations; Prepare for Any Outcome
- Ask Specific Questions; Identify Issues; Make no Guarantees; Witness and Document Meetings
- Evaluate the Character "C": Is borrower acting like an Optimist, an Ostrich, or an Obstinate?
- Do not fear Bankruptcy or Litigation Threats, but Beware of Lender Liability Claims (informal promises; breach of good faith; breach of fiduciary duty; unfair trade practices; etc.)

Don't Minimize or Postpone Issues – Problems Do Not Age Well!!

- Focus on return *OF* the principal, not return *ON* the principal (you can't re-price yourself to safety)
- Keep bank management and/or counsel informed; develop a plan and execute
- Speed can be the difference in success and failure. You could be racing your competition!

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Section 3 – Strategies to Minimize Bank Losses

Should We Use Carrots, Sticks, or Something In Between to Minimize Bank Losses?

"We're trying a new incentive program. Bacon?"

"If you've already sent in your payment, kindly disregard this friendly reminder."

Notable Quote:

"Everyone has a plan until they get punched in the face." - M. Tyson

Section 3 – Strategies to Minimize Bank Losses 11

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Offering "Carrots" to a Borrower
Tools and Tactics to Incentivize the Borrower

Payment Plan; Short Term Renewals; Rate Changes; Extended Maturities; Additional Advances; Payment Deferrals; Short-Sales; Confession of Judgment (Reduced) ; "Cash for Keys"

PROS

- Everyone in a positive frame of mind.
- Could solve the Borrower's immediate need.
- Provides a better picture of the situation.
- Chance to review and "clean up" existing documentation.
- A chance for additional collateral/guarantee.
- No long-term obligation.

CONS

- Sometimes no additional legal protection.
- Could be waiving future remedies.
- Could be throwing good money after bad (i.e. digging a deeper hole).
- Possibly delaying the inevitable.
- Could be triggering impairment treatment.

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Using "Sticks" as the Lender
Tools or Tactics Advantageous to the Lender

Take Advantage of the Law and Contractual Terms and Conditions

Legal Remedies for the Bank: Default Notices (technical or substantive) / Right to Cure; Offsets; Repossession; Debt Acceleration; Cross-Default; Foreclosure; Receiver Appointment; Judgment; Involuntary Bankruptcy

PROS

- Informs the Borrower of Seriousness.
- Provides Certainty of the Legal Process.
- Can always back off the later.
- Counsel is available to identify issues.

CONS

- Legal is a delayed and costly (judicial) process.
- Can invite needless litigation (counterclaims).
- Must avoid consumer regulatory protections.
- You might need the Borrower's help later.
- South Carolina is a pro-debtor state!

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A Great Compromise: The Forbearance Agreement
A customizable agreement that *suspends* the Bank's legal remedies and incentivizes Borrower to resolve issues.

- Does not have to give up any of the Bank's legal rights.
- Can solve the Borrower's immediate needs and inspire action.
- Obligates and engages the Borrower to follow a formal and legally binding plan.
- The agreement can be completely customized (duration; requirements; obligations).
- Can reduce or eliminate litigation risk for the Bank.
- Does not have to be a public filing (i.e., terms can be confidential).
- Often counsel for both parties work together to come to sensible agreement.

"You Can't Always Get What You Want"
The Rolling Stones

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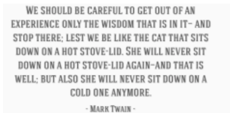
Section 4 – Lessons Learned / Predictions



Notable Quotes:
"If we are going to make mistakes, can we please make *new* ones this time….." Samuel R. Small, Jr.
"Let's just make one error per play, fellas…" – the Winning Tee-ball Coach

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Lessons Learned from Days Passed

Things We Have Proven

- There's no substitute for knowing your borrower. An individual (not an entity) makes the payment.
- (Global) cash flow is king. Never lead with the collateral or any secondary source of repayment.
- Collateral can depreciate (sometimes rapidly). Negative equity has known to exist !!
- Paper equity could be worth what it is written on. There's no substitute for "skin in the game."
- Speed to resolution can be the difference between success and failure. Don't avoid issues.
- Historical performance is very important, but it is not a guarantee.

Thoughts and Statements to Avoid

- "There's *plenty* of additional collateral, so there can never be a Bank loss."
- "We must do the loan because *all* the banks were doing them, and I have goals to meet."
- "I didn't know the borrower well, but I wanted to accommodate a good referral source for me."
- "The loan is so good that I would have done it myself."
- "I had a slight suspicion that if the going got tough the borrower might not pay timely."
- "If we just give it some more time, it will work itself out."
- "This has always worked in the past, so there's no reason not to do the loan."
- "The borrower provided a pro forma that proved the project would be successful."
- "Don't worry about the one 'weak partner' – the others are strong!"

OREO Pro Tip: Never be the first person to open the refrigerator in a bank-repossessed property !!

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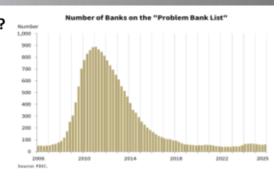
Predictions: Which Way are we Headed?

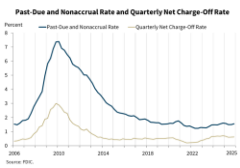
2025 – 4Q
Texas Ratio of all South Carolina Banks (43)

- **Median: 2.13%**
- **Average: 3.85%**

2025 – 4Q
Net Charge-offs/ Avg. Loans of all SC Banks (43)

- **Median: 0.02%**
- **Average: 0.08%**





Note: The reserve coverage ratio is the allowance for credit losses to noncurrent loans and leases. The term "noncurrent loans" is used to describe loans that are 90 or more days past-due or on nonaccrual status.

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Predictions: What are the Headlines and "Pundits" Saying?

THE WALL STREET JOURNAL. Is Another Financial Crisis Lurking in Private Credit (April 1, 2026)
U.S. Officials Try to Get a Grip on Risks Bubbling Inside Private Credit (April 22, 2026)

AMERICAN BANKER Iran-related Risks Manageable for Banks, but Duration is Key (April 22, 2026)

The Economist Trouble is Brewing Among America's Corporate Borrowers (March 15, 2026)

S&P Global Market Intelligence Banks and the Not So "Hidden" Exposure to Private Credit (March 26, 2026)

CNBC Private Credit's Zero Loss Fantasy is Coming to an End as Defaults and Fund Exits Rise (March 25, 2026)

American Bankers Association. Bank Economists: Credit Conditions Will Hold Steady Over Next Six Months (March 6, 2026)

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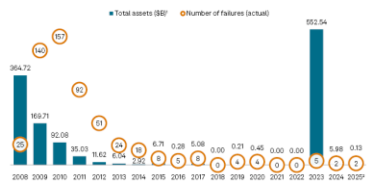
Take Comfort: Credit Quality is a Significant Risk, but not the Only Bank Risk…..

US bank failures since 2008



Data compiled June 30, 2025.
Analysis limited to failures by US commercial banks, savings banks, and savings and loan associations between Jan. 1, 2008, and June 30, 2025.
[1] Total assets based on most recent regulatory filings before failure.
[2] Year to date through June 30, 2025.
Source: S&P Global Market Intelligence.
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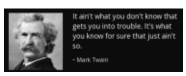

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Additional Resources: **https://www.fdic.gov/**

FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

FDIC FIL: 34-2023: Interagency Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts **(June 29, 2023)**
FDIC FIL 64-2023: Advisory: Managing Commercial Real Estate Concentrations in a Challenging Economic Environment **(December 18, 2023)**

Lending Standards

- *Standards for Safety and Soundness*, Part 364 of FDIC Rules and Regulations, Appendix A, https://www.ecfr.gov/current/title-12/chapter-III/subchapter-B/part-364.
- *Real Estate Lending Standards*, Part 365 and Subpart A to Part 365, https://www.ecfr.gov/current/title-12/part-365/subpart-A.

CRE Concentrations

- *Interagency Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices*, December 6, 2006, https://www.fdic.gov/news/financial-institution-letters/2006/fil06104.html.
- *Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts*, June 29, 2023, https://www.fdic.gov/news/financial-institution-letters/2023/fil23034a.pdf.
- *Joint Statement on Prudent Risk Management for Commercial Real Estate Lending*, December 18, 2015, https://archive.fdic.gov/view/fdic/284.

Accounting

- *Interagency Policy Statement on Allowances for Credit Losses (Revised April 2023)*, April 21, 2023, https://www.fdic.gov/news/financial-institution-letters/2023/fil23017.html.

Credit Risk Management

- *Interagency Guidance on Credit Risk Review Systems*, May 8, 2020, https://www.fdic.gov/news/financial-institution-letters/2020/fil20055.html#.
- *Interagency Supervisory Guidance on Stress Testing for Banking Organizations with More than $10 Billion in Total Consolidated Assets*, May 14, 2012, https://archive.fdic.gov/view/fdic/4634.
- *Interagency Statement to Clarify Supervisory Expectations for Stress Testing by Community Banks*, May 14, 2012, https://archive.fdic.gov/view/fdic/4633.

Appraisals

- *Appraisals*, Part 323 of FDIC Rules and Regulations, https://www.ecfr.gov/current/title-12/chapter-III/subchapter-B/part-323.
- *Interagency Appraisal and Evaluation Guidelines*, December 10, 2010, https://www.fdic.gov/news/financial-institution-letters/2010/fil10082a.pdf.
- *Interagency Advisory on Use of Evaluations in Real Estate-Related Financial Transactions*, March 4, 2016, https://www.fdic.gov/news/financial-institution-letters/2016/fil16016a.pdf.
- *Advisory on the Availability of Appraisers*, May 31, 2017, https://archive.fdic.gov/view/fdic/6464.
- *Frequently Asked Questions on the Appraisal Regulations and the Interagency Appraisal and Evaluation Guidelines*, October 16, 2018, https://www.fdic.gov/news/financial-institution-letters/2018/fil18062a.pdf.

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Questions / Review

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